

RISKS AND RISK MANAGEMENT

Kungsleden's operations are mainly oriented on owning, managing and developing offices and other commercial premises, focusing on offices in Stockholm, as well as Sweden's other growth regions. We operate on the Swedish market exclusively, and accordingly, are influenced by how the Swedish economy progresses. The Board of Directors bears overall responsibility for risk management, while operating activities are delegated to the CEO and management.

Kungsleden is continuously exposed to various risks that may be significant to the company's future operations, results of operations and financial position. We work actively to identify and manage the risks and opportunities that are material to our operations.

RISK	DESCRIPTION	MANAGEMENT
Business environment risks		
Macroeconomic risk	A weak economy negatively impacts the demand for premises, which results in increased vacancies, decreasing market rents and no indexation on existing lease contracts. Additionally, the risk of tenants' payment problems increases, which has a negative impact on cash flow.	This type of risk and its management is continuously assessed by management and the Board of Directors, and through regular analysis of our market and business environment. Strategic actions to reduce the company's exposure are determined each year.
Crisis management	For Kungsleden, a crisis is an unexpected event that threatens to damage our operations or brand seriously, and that our regular organisational resources are unable to manage.	Kungsleden has a crisis management plan to deal with this type of extreme event. This type of risk is managed at an overall level in several ways, including a succession plan for senior executives and full value insurance for real estate.
Risks related to property development		
Rental revenues	Kungsleden's rental revenues are affected by economic progress on those markets where we operate, and how well we succeed in developing the locations where our properties are located. Economic growth probably causes increased demand for premises, which usually results in higher market rents. Presumably, negative economic progress has the opposite effect.	Mainly, Kungsleden holds properties on growth markets, a contract portfolio with a large number of contracts and diversified maturity structure. We endeavour to maintain a contract portfolio with fairly long contract maturities. The average contract duration across the whole portfolio is 3.7 years. Our experienced and skilled management and lettings staff work actively on the re-negotiation-process before contract expiry.
Property costs	The risks on the cost side relates mainly to cost increases over and above what Kungsleden is able to offset through contracted rents, indexation and re-invoicing supplements. These risks also include unforeseen risks and any need for extensive refurbishment. A high share of this cost relates to energy consumption through heating, cooling and electrical power.	A portion of property costs are re-invoiced to the tenant through adjustments of lease contracts, and accordingly, cost increases or savings have a limited impact on our earnings. Any vacancies impact property costs by us being unable to re-invoice certain costs. Kungsleden appointed a central Technical Manager in 2018 to work proactively on the technical condition of its property portfolio, and thus reduce the risk of unforeseen costs. We work on rationalising energy consumption on a target-oriented basis. This includes us setting a target for reducing energy consumption by 3 per cent annually in 2014–2020.

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Risks related to property development, cont.		
Project development	<p>Project development is value creating but may also be associated with risk. This includes increased credit risk on large, tailored projects resulting from tenants being unable to fulfil their rent obligations, and Kungsleden being unable to find other tenants for the relevant premises.</p> <p>There is also a risk of a reduced return on projects if major construction and refurbishment work is delayed and/or becomes more costly than forecast.</p> <p>Additionally, there is a risk of reduced revenues due to delays that mean tenants are unable to utilise premises at the expected time.</p> <p>Moreover, Kungsleden is dependent on receiving the necessary permits from regulatory authorities so that it can execute projects.</p>	<p>Risks related to project development are managed through channels including project execution not commencing until 50 per cent of areas are leased. In recent years, Kungsleden has accumulated highly skilled and experienced organisational resources in project development. Additionally, Kungsleden has rigorous and quality-assured property development processes and procedures.</p> <p>Each project includes an initial risk analysis, which is followed up during the project life-cycle. Total cost estimates are conducted at least quarterly on all major projects, and measures taken if these forecasts indicate delays or cost increases.</p>
Property values	<p>Kungsleden accounts its properties at fair value, i.e. market value, which has a direct impact on results of operations and financial position. The value of properties is impacted by several factors such as exogenous factors that affect supply and demand such as the business cycle, interest rate level, financing and required yield. The structure of contracts and customer base, as well as Kungsleden's capability to manage, improve and develop its properties also impact value.</p>	<p>To manage the risk of negative value changes, Kungsleden works actively on diversifying risk between categories of premises and tenant, geography and contract size. Our average contract duration is 4.7 years for our 10 largest tenants, and 3.7 years for all tenants, which means that variations in market rents do not have an immediate impact on rental revenues. Kungsleden's target is to have balanced portfolio risk with a limited impact of exogenous factors, and we value our whole property portfolio internally each quarter. Our valuations are based on an analysis of cash flow, which includes assessments of a property's future earnings capacity and market required yield. This internal valuation is the foundation of reported property values. Internal valuations are conducted by staff with extensive valuation experience. We conduct annual external valuations of our whole portfolio each year to quality-assure and verify our internal valuations. The sensitivity analysis regarding property values and loan-to-value ratio is shown in the table below.</p>
Sustainability risks		
Pollution and climate impact	<p>The risk of land contamination that entails remediation costs, mainly relating to development, when property usage alters. In addition, extreme weather events and climate change may result in a risk of damage to properties.</p>	<p>Kungsleden has categorised all its properties according to their risk of soil contamination, and takes proactive measures. On acquisition, Kungsleden determines the risk of soil contamination, environmentally hazardous construction materials and climate risks. Risks associated with climate impact are managed through proactive measures in preventative maintenance.</p>
Business ethics/ corruption	<p>The risk of impropriety against Kungsleden by employed staff or contractors that could damage the company's finances, brand and employees' well-being and trust.</p>	<p>Internally, Kungsleden's work is governed by stable regulatory structures consisting of policies and guidelines. We operate and communicate on the basis of collective core values based on professionalism, caring and joy. Kungsleden's leadership pledge complements our core values with the conduct that we expect from our leaders.</p> <p>Externally, our work is regulated by a Code of Conduct for suppliers. Additionally, Kungsleden works actively internally and externally on information associated with its work in business ethics. Kungsleden has an internal Ethical Council that deals with any incidents.</p>

Sensitivity analysis, property valuation and loan-to-value ratio

Value parameter	Assumption	Value impact, SEK m	Impact on LTV ratio
Rental value	+/- 1%	+526/-526	-0.7%/+0.7%
Operating cost	+/- 1%	-124/+124	+0.2%/-0.2%
Required yield	+/-0.1 percentage points	-529/+549	+0.7%/-0.7%
Economic occupancy rate	+/- 1%	+526/-526	-0.7%/+0.7%

The sensitivity analysis illustrates how a change in a selected value parameter impacts property value and LTV ratio.

RISK	DESCRIPTION	MANAGEMENT
Sustainability risks, cont.		
Social conditions and human rights	Kungsleden has a large supplier base, and its major projects involve multiple participants. Because it is difficult to overview supply chains, there is a risk of activities conflicting with Kungsleden's values.	Kungsleden applies a clear Code of Conduct for suppliers and its suppliers are informed about the importance of conduct compliant with Kungsleden's core values.
Organisational risk	Employees are one of our key assets. The major risk is that we are unable to hire, develop and retain staff and managers with appropriate competence.	Kungsleden operates and communicates on the basis of collective core values: professionalism, caring and joy. These define how Kungsleden as a company, and our individuals, want to be dealt with, and how we deal with people in our day-to-day work. Kungsleden's leadership pledge complements our core values with the conduct that we expect from our leaders, and what we believe is necessary for us to achieve our long-term goal of being the most attractive and sustainable workplace in the property sector. Organisational risk is managed through channels including succession planning for senior executives.
Financial risks		
Financing	The risk that borrowing cannot be arranged or can only be arranged on unfavourable terms. Kungsleden's business model is based on real estate assets being funded with equity and external borrowings to generate healthy returns on investor capital. Accordingly, access to external capital is a critical factor to enable successful real estate operations.	Kungsleden shall maintain financing risk at an acceptable and controlled level by operating with an LTV ratio of not more than 50 per cent for the long term. Kungsleden also utilises a variety of reputable lenders such as banks and lenders in the capital markets, and thus achieves well-diversified borrowing. Significant maturity concentrations are countered by diversifying the maturities of agreed loans and limiting the share of maturities over the coming 12 months so that they do not exceed 30 per cent of total loan volume. Kungsleden limits counterparty exposure so that individual lender commitments do not exceed 30 per cent of total loan volume.
Interest	On short maturities, market interest rates are primarily impacted by the monetary policy of Sweden's national bank, while for longer maturities, interest rates are determined by expectations of future economic progress and inflation, nationally and internationally. Changes in market interest rates can have an impact on earnings and cash flow. Accordingly, finance with short fixed interest periods implies an uncertainty regarding future financing costs. Because swaps entered are subject to continuous market valuation pursuant to IFRS, there is a risk that negative unrealised value changes on financial instruments will occur if market interest rates on longer maturities fall after the hedging contract has been entered. Accordingly, negative unrealised value changes on financial instruments can affect the Group's results of operations and financial position.	Interest risk is managed at an overarching group level. Kungsleden's finance policy stipulates a framework for its interest rate duration strategy determined by the Board of Directors, which is expressed in maturity intervals and variance intervals. Balancing short and long fixed interest periods is conducted on the basis of the state of the market, the Group's ability to cope with negative scenarios, and the current view of risk. Each year, the Board of Directors sets intervals for the share of loan interest rates that should be fixed within different maturity intervals. The desired risk interval is achieved utilising interest rate swaps or interest rate caps. All financial instruments utilised should be liquid, and the Treasury function should possess a high level of knowledge about the function, risk and pricing of each instrument.

RISK	DESCRIPTION	MANAGEMENT
Financial risk, cont.		
Liquidity	Liquidity risk is defined as the risk of not having access to cash and cash equivalents or credit facilities to satisfy payment obligations. Cash and cash equivalents means cash at hand and available credit commitments.	At any time, Kungsleden should maintain contingency to make at least three months' known payments including interest payments and loan roll-overs. Contingency also means agreements on overall terms & conditions for financing are in place. The Board of Directors is entitled to decide on temporary increases to liquidity, e.g. given increased contingency for major transactions. Kungsleden has overdraft facilities to enable flexible cash management.
Credit	Credit risk is defined as the risk that a counterparty is unable to fulfil all or part of its obligations. Credit risk is present in derivative contracts, when issuing vendor notes and investing surplus liquidity. Credit risk also means the risk that the counterparty does not pay its rent or sales proceeds.	Derivative transactions may only be entered with counterparties that have high credit ratings. At present, Kungsleden has entered derivative contracts with the Nordic region's five major banks. Collateral is usually secured for significant long-term receivables to reduce credit risk. A financial analysis of tenant solvency and credit checks are conducted on signing lease contracts. Historically, rent losses have been very low.
IT risks		
Virus attacks	The risk that files are encrypted and systems stop working.	Through its system administration partner, Kungsleden possesses secure protection against viruses and spam, which is updated continuously. There are procedures for our external system administration partner to counter attacks at an early stage, and for restores post-incident.
System outage	The risk of the complete IT environment or parts of it becoming unavailable.	This risk is managed by maintaining a close collaboration with our system administration partner (Visolit) who in collaboration with us, ensures that Kungsleden maintains an updated technology platform and the necessary backups, as well as restoration plans for any major system outage.
Data breaches	The risk of unauthorised access to the company's data.	Kungsleden conducts regular penetration tests through our external system administration partner. We also use two factor authentication to minimise the risk of data breaches.
Fraud	The risk of fraudsters contacting Kungsleden with the aim of securing payment.	Kungsleden maintains clear procedures and processes for executing payments. We conduct continuous training and keep staff informed to maintain a high level of risk awareness for all employees.
Tax		
Changes to tax regulations	Alterations to the regulatory structure that determines corporation and property tax may affect Kungsleden's potential for its operations positively or negatively. For example, altered regulation on the sale of real estate and companies that own real estate.	Tax risks are mainly managed through proactive work relating to new developments in the tax segment. We maintain continuous communication with the Board of Directors and Audit Committee on tax risks and their management, and analyse complex tax issues with the help of external consultants. We also limit property tax risk by much of this tax being reinvoiced to tenants.